

# THE VIRGINIA STATE BANKER

Regulatory News for Virginia State-chartered Banks  
State Corporation Commission - Bureau of Financial Institutions  
Commissioner E.J. Face, Jr.  
ISSUE NO. 4 — FALL 1998

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The Virginia State Banker is published quarterly by the Virginia Bureau of Financial Institutions to provide useful information to the banks and savings institutions that it regulates, and any of their related interests. Reader comments and suggestions are welcome and should be addressed to:

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Commissioner Face, Nick Kyrus, John Crockett, Ricky McCormick, Joanne White, and Jane Owen.

SPECIAL THANKS to Andrea Leeman for producing the Bureau Profile Article.

## BUREAU HOLDS 1998 ANNUAL MEETING FOR EXAMINERS

Bureau bank examiners and other staff met during the week of September 28 in Richmond for an intense week of training and discussion. At what is referred to as the "Annual Meeting," examiners received refresher training in Windows 95. The State Corporation Commission recently completed a switch to Windows 95 and the Microsoft Office 97 suite of products.

A significant amount of time was devoted to training in the latest version of ELVIS (Examiner Laptop Visual Information System). Representatives of the Federal Reserve System provided useful background information, and detailed some of the problems encountered in their implementation and usage of ELVIS. Immediately following the training, our examiners began to use ELVIS on examinations. This interagency regulatory tool assists examiners in conducting a "risk focused" examination and in customizing the examination to fit the institution. (As a side note, the folks at Graceland have complained about the use of the name ELVIS. ELVIS will be renamed ED.)



The week's discussion topics included Year 2000, recent changes in regulation, interest rate risk measurement, and GENESYS. GENESYS is another of the interagency tools, and primarily facilitates examination analyses by providing financial and archived historical information through a data download. This tool also produces a report of examination. We anticipate using GENESYS beginning in the second quarter of 1999.

The week concluded with a message from Commissioner E. J. Face, Jr. The Commissioner covered a number of subjects including the state of State-chartered banking in Virginia and the nation; interstate banking and interstate regulation; financial modernization legislation; expansion of powers of national banks; Year 2000; unitary thrift charter; and lending standards. The Commissioner stated he intends to make a great Bureau of Financial Institutions even better. He challenged the examiners, analysts, and other staff present to be proactive and willing to change.

## RECENT ANNOUNCEMENTS!!

### NEW LAW BOOKS TO BE DELIVERED SOON

Each State bank or savings institution should receive two copies of the 1998 "**Laws of Virginia Related to Financial Institutions**" in the mail shortly. The publication, includes the 1998 enactments of the General Assembly. Once you have received your new copies of the law book, you can dispose of your 1996 Laws of Virginia Related to Financial Institutions, along with the 1997 Supplement and the 1998 Supplement.



If you have any questions relating to changes in the law, please contact the Bureau at (804) 371-9657. If you have questions pertaining to the book itself, i.e., you did not receive your copies, please contact Joanne White at (804) 371-9697.

### TWO NEW STATE-CHARTERED BANKS ARE APPROVED

The State Corporation Commission recently approved two new banks in Virginia. They are **First Capital Bank** in Henrico County and **Monarch Bank** in Chesapeake.



First Capital Bank was authorized with total capital of \$7.7 million and its Chief Executive Officer is Esther Hay Smith. Monarch Bank was authorized with total capital of \$8.0 million, and its Chief Executive Officer is William F. Rountree (aka "Tree").

In addition, three new Virginia bank applications are pending: The Bank of Williamsburg, Williamsburg (total capital \$4.0 million) which is being organized by Union Bankshares Corporation, Bowling Green; Albemarle First Bank, Charlottesville (total capital \$7.3 million); and TowneBank, Portsmouth (total capital \$30 million). Thus far in 1998, the Commission has authorized six new banks.

## BUREAU EMPLOYEES RECOGNIZED FOR YEARS OF SERVICE

The State Corporation Commission recently held its annual ceremony to recognize its employees for dedicated years of service. Service Pins are presented to employees after five years of service and at subsequent five-year intervals by their division directors. The following is a list of employees of the Bureau of Financial Institutions who received Service Pins at the ceremony:



#### 5 YEARS

**Teresa Batton** – Banks and Savings Institutions  
**Robin Hall** – Banks and Savings Institutions  
**Daniel Hearn** – Banks and Savings Institutions

#### 10 YEARS

**Joyce Tinsley** – Corporate Structure and Research  
**G.R. Blevins** – Consumer Finance  
**Gerald Cenzone** – Banks and Savings Institutions  
**Jeanette Hamilton** – Consumer Finance  
**Martin Holbrook** – Banks and Savings Institutions  
**Susan Hancock** – Consumer Finance  
**Lynda Ramsey** – Banks and Savings Institutions

#### 15 YEARS

**Robert Bishop** – Banks and Savings Institutions

#### 20 YEARS

**Mary Lou Kelly** – Administration and Finance  
**Jane Owen** – Banks and Savings Institutions  
**Evelyn Taylor** – Administration and Finance

#### 25 YEARS

**Wayne Giles** – Corporate Structure and Research  
**John Turner** – Banks and Savings Institutions

## **BUREAU PROFILE**

### **JOHN M. CROCKETT DEPUTY COMMISSIONER BANKS AND SAVINGS INSTITUTIONS**



**John M. Crockett**  
**Deputy Commissioner**

When John Crockett got a job with the Bureau of Financial Institutions, cabooses were still required to be the last cars on freight trains. In 1977, John was the equivalent to the caboose for BFI. A financial institutions examiner trainee, John started at the end of the line and began a steady chug forward. John, now one of four deputy commissioners for the bureau, oversees the work of several dozen people who are ultimately responsible for the financial stability of State-chartered banks and thrifts in Virginia. "It's a team effort," says John. "There's no way I could even dream of doing everything that has to be done, so you have to rely on your people, and I have a great group of people."

Those people scrutinize the 125 or so banks and thrift institutions chartered in Virginia. A decade ago, that number would have been absolute and fairly constant. Not so, anymore. Ask him precisely how many entities his section regulates and his response might well be, "What time is it?" With mergers and sales and spin-offs, John says at times it's hard to keep up. "We've got at least a dozen banks in some stage of becoming new State-chartered banks." "It's been wild," he says. "I don't ever remember this much banking activity in the 21 years I've been with the Bureau."

John graduated from high school and went to what was at the time Ferrum Junior College. He hadn't much thought about what he was going to be when he grew up. Business held his interest, however, and a little guidance from the president of the college steered him toward the business school at the University of Richmond. At the time, John says, U of R's business school was ranked as one of the top in the country — without the big price tag. "It wasn't Harvard or Columbia, but it didn't cost an arm and a leg, either," says John. The Associate degree from Ferrum and the BS degree from U of R have served him well. Within two years of his debut as an examiner trainee, John was the Bureau's prototypical bank analyst. The idea was the brainchild of then-Commissioner Sid Bailey and deputy commissioner George Petry. As part of an early warning system of sorts, the bank analyst would look at specific trends — ratios in profit, capital, liquidity — that would indicate potential trouble for the institution. By addressing adverse conditions early, bankers could usually avoid bigger problems.

Ten years later, when Mr. Petry left, John became acting deputy commissioner. He moved permanently into the position he now holds in 1991. He has no typical day. "You never know what the computer's going to deliver or what the telephone is going to bring," he says. Demands on his time are "...like grapes, they come in bunches." He just got back from a meeting with the Georgia banking department regarding a merger proposal involving Virginia's largest State-chartered bank. His job, however, is not the only time consumer. He has a wife and daughter at home. He sings in the church choir, participates in a citizen police academy in Hanover County, and this year is playing host to a foreign-exchange student from Spain.

Then there's his "car" collection — N-scale train cars, that is. The collection of freight cars, coal cars, passenger cars, engines and cabooses now numbers nearly 250. The term "N-scale" refers to the size of the rail cars (which measure about three inches, depending on their purpose). The N-scale proportion to an actual car or a locomotive is 1:160. John says the term also refers to the nine-millimeter distance between the rails on the track. Proportioned to fit, a rail car on a track width of nine millimeters would be 1/160 that of a real boxcar. Lionel trains, with which many people are familiar, are based on an O scale (1/48). There are also H/O scale models (about half of O); but, according to John, "N-scale is the only scale." He didn't come from a long line of railroad workers. He didn't grow up near the tracks. Holding a hand about knee high from the floor, John recalls, "Way back when, my dad set up a Marx tin-plate Santa Fe passenger train on an oval of track." He doesn't know what became of that very early train set, but admits that experience prompted his interest in model trains. In the meantime, John will keep his seat behind the conductor and, with the help of his crew, work at keeping Virginia's banks and thrift companies on track.

# TIPS TO HELP FIGHT CHECK KITING



The Bureau has seen a number of instances in which banks have incurred significant losses through check kiting. Check kiting is made possible by permitting a customer to gain access to deposited funds before they are collected from the institution on which they are drawn. The institutions most susceptible lack proper internal controls and reporting systems, or have failed to properly enforce existing internal procedures. Liberal practices regarding funds availability and wire transfer activity further increase the potential for loss.

The board and senior management of an institution should ensure the effectiveness of internal controls used to minimize risk and identify suspicious activity. While fraudulent conduct cannot be detected or prevented in every case, controls should reduce the likelihood that a kite will go undetected. The types of internal controls which banks should consider include:

- Officer approval on drawings against uncollected funds, overdrafts, and wire transfers. This authority should be strictly enforced and not exceed an individual's lending authority.
- Daily reports on drawings against uncollected funds, overdrafts, large items, and significant balance changes. A designated individual should regularly review such reports to spot suspicious conduct and to ensure timely investigation.

With proper controls, institutions increase their ability to flag suspicious activity. Although not all questionable conduct is a fraud in process, knowing the potential warning signs and monitoring such conduct helps identify possible illegal activity. Examples of circumstances which may indicate a check-kiting scheme include the following:

- Several accounts with similar names, owned or controlled by the same individuals.
- Regular or excessive drawings against uncollected funds.
- Frequent negative ending balances or overdrafts that eventually clear or are covered in a short time frame.
- Identifiable patterns of transactions such as deposits, transfers between accounts, withdrawals, and wire transfers, often with similar or increasing amounts.
- Deposits of large checks drawn on out-of-area banks or foreign banks.
- Frequent requests by the customer for account balances, collected items, or cleared items.
- Frequent, large deposits drawn on the same institution.
- Deposits drawn on other institutions by the same maker or signer.
- Large debits and credits of even dollar amounts.
- Frequent check withdrawals to the same institution, with the maker listed as payee.
- A low average daily balance in relation to deposit activity.
- A low collected-funds balance in relation to the book balance.
- A volume of activity or large debits and credits inappropriate in relation to the nature of the business of the account holder involved.

Most financial institution data processing servicers and software vendors include the capability to produce kite suspect reports. Although the usefulness of these reports varies, the reports may be an important tool in an effective kite suspect identification and monitoring program. The controls in place to detect and prevent check kiting should be subject to periodic review by internal audit or similar internal control reviews. Any bank that becomes aware of activity suggesting the existence of a check-kiting scheme should file a suspicious activity report.



# TECHNOLOGY ISSUES

## **CONFIDENTIALITY OF YEAR 2000 ASSESSMENT RATING**

Information from Year 2000 assessments are governed by the same rules of confidentiality that apply to examinations for safety and soundness, compliance, information systems, and trust activities. Under Virginia law and Federal regulations, disclosure of reports of examination, or any information contained in them, is strictly prohibited. Accordingly, institutions may not disclose results from Year 2000 assessments just as they may not disclose other types of examination information.

Disclosure of such information to third parties such as financial ratings firms or fidelity bond carriers is likewise prohibited. Requests from such entities for ratings are not authorized by any banking regulator. In light of the blanket prohibition on disclosing ratings, compilations of Year 2000 ratings by any firm is incomplete and unreliable.

While the disclosure of Year 2000 assessment information is prohibited, the Bureau strongly encourages financial institutions to publicly disclose the steps they have taken to address Year 2000 issues. Such disclosures are an effective method for institutions to inform customers of their Year 2000 readiness.

The Year 2000 readiness of the majority of service providers and selected software vendors is also assessed by the regulators. This assessment information of these service providers, and those software vendors who consent to disclosure, is provided to their financial institution customers. However, under the same disclosure rules that apply to financial institutions, service providers and software vendors may not disclose their Year 2000 assessment information, and insured financial institution customers may not disclose the assessment information of their service providers or software vendors. The regulators do not certify Year 2000 compliance of service providers or software vendors, nor do we rank their Year 2000 readiness efforts. Service providers and software vendors have also been encouraged to share with their customers the steps they have taken to address Year 2000 issues.

## **YOUR WEBSITE ... SERVING UP INFORMATION OR FRUSTRATION**



A recent survey of online visitors to bank websites found that more than 80% leave the sites out of frustration. The causes of the frustration ... dead ends, lots of scrolling to find information, or too many clicks to get to the desired information. More than 70% of site visitors reported delayed or no response to e-mail messages. Take heed ... customers and potential customers who abandon your website may not return. Great websites provide easy navigation, frequent updates, useful information, prompt e-mail responses, and helpful links.

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## **FDIC SITE PROVIDES USEFUL INSURANCE DATA**

Ever have difficulty determining the amount of deposit insurance, or ever been unable to respond to a customer's deposit insurance inquiry? The FDIC has added the Electronic Deposit Insurance Estimator (EDIE) to its Internet website at [www.fdic.gov](http://www.fdic.gov). EDIE guides users through questions about deposit accounts, and prints a report clearly showing the amount of insurance coverage. The program is designed to allow even novice computer users to get accurate statements of deposit insurance coverage.

EDIE can accommodate the needs of most individuals and family groups. It can calculate insurance coverage for single, joint, testamentary, and IRA/Keogh accounts. EDIE cannot be used to calculate insurance coverage for business accounts or complex ownership arrangements, such as living or family trusts and employee benefit plans.

Institutions are encouraged to ensure that employees understand the deposit insurance rules so customers will receive accurate information. EDIE may be used in a number of ways. Incorporate EDIE into your deposit insurance training program, or provide Internet access to employees who work with depositors to assist them in advising customers. FDIC invites institutions with Web pages to link EDIE to their Internet sites.

# **REGULATORY AND ACCOUNTING UPDATES**

## **ACCOUNTING AND REGULATORY REPORTING CHANGES**

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Under Statement No. 133, all derivatives are recognized as either assets or liabilities on the balance sheet and must be measured at fair value. If certain conditions are met, a derivative may be specifically designated as a fair value hedge, a cash flow hedge, or a hedge of a foreign currency exposure of a net investment in a foreign operation. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

Statement No. 133 is effective for all fiscal quarters of fiscal years beginning after June 15, 1999 with earlier application encouraged. Banks must adopt Statement No. 133 for Call Report purposes upon its effective date based on their fiscal year. Early application is permitted in the Call Report in accordance with the transition guidance in Statement No. 133.

## **American Institute of Certified Public Accountants (AICPA) Statements of Position 98-1 and 98-5**

Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed*, provides guidance on whether costs of internal-use software should be capitalized and then amortized, or expensed as incurred. Internal-use software has the following characteristics: (i) the software is acquired, internally developed, or modified solely to meet the entity's internal needs, and (ii) during the software's development or modification, no substantive plan exists or is being developed to market the software externally.

Statement of Position 98-5, *Reporting on the Costs of Start-Up Activities*, requires costs of start-up activities and organization costs be expensed as incurred. SOP 98-5 defines start-up activities broadly as "those one-time activities related to opening a new facility, introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer or beneficiary, initiating a new process in an existing facility, or commencing some new operation."

Both SOPs are effective for financial statements for fiscal years beginning after December 15, 1998. Early application is permitted in the Call Report in accordance with the transition guidance in the SOPs.

## **TRUST RATING SYSTEM RECENTLY REVISED**

The Uniform Interagency Trust Rating System (UITRS) has been revised to reflect industry and regulatory changes that have occurred since the rating system was first adopted in 1978. The Bureau uses this rating system, as do our regulatory partners, to uniformly evaluate the administration of fiduciary activities of trust departments and companies, and to identify those institutions requiring special supervisory attention. The revised rating system became effective on October 13, 1998 with its publication in the Federal Register. The new UITRS will be applied to examinations beginning January 1, 1999.

The changes revise the definitions to conform to the language and tone of the Uniform Financial Institutions Rating System (UFIRS), commonly referred to as CAMELS, rating definitions. CAMELS, the interagency rating system for

## **REGULATORY AND ACCOUNTING UPDATES (continued)**

financial institutions, was also adopted in 1978. CAMELS was given an overhaul effective January 1, 1997. A major change in the UFIRS and UITRS revisions is the inclusion of language specifically addressing the quality of risk-management practices.

The "components rating" "composite rating" structure of the former UITRS has been retained. Under the former system, six components were rated: Supervision and Organization; Operations, Controls, and Audits; Asset Administration; Account Administration; Conflicts of Interest; and Earnings, Volume Trends, and Prospects. Under the new UITRS, the number of component rating categories is reduced from six to five. The former Account Administration and Conflicts of Interest components are addressed in a new Compliance component. Also, the Earnings component need not be rated in institutions with \$100 million or less in trust assets.

The composite rating reflects the overall condition of fiduciary activities and describes the level of regulatory attention required, and has been retained in the new UFIRS. The descriptions have been changed, and are more closely aligned with the CAMELS composite descriptions. The "1" to "5" numerical scale has been retained for both the composite and component ratings. A "1" indicates the strongest performance and management practices, and the least degree of supervisory concern, while a "5" indicates the weakest performance and management practices and the highest degree of supervisory concern. Please contact our office for a complete copy of the Uniform Interagency Trust Rating System and/or the Uniform Financial Institutions Rating System, and the related supplementary information.

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## **DEBT COLLECTION ACT of 1996 PRESENTS OPPORTUNITIES FOR BANKS TO GROW**

The Debt Collection Improvement Act of 1996 requires the federal government to use electronic funds transfer (EFT) to pay its financial obligations, except tax refunds, beginning January 2, 1999. "Financial obligations" includes federal salary, retirement, and benefit payments. The Treasury Department is leading this transition, dubbed EFT '99, toward electronic federal government payments. With all the focus on Year 2000, EFT '99 attention seems to have waned. EFT '99 presents a tremendous opportunity to convert existing customers to direct deposit, and perhaps to convert the unbanked into customers.

The Treasury Department issues more than 300 million checks annually, and most persons with bank accounts will elect to receive federal payments by direct deposit. It is estimated that as many as 10 million people nationwide, without bank accounts, cannot take advantage of direct deposit. The Treasury Department, through its Financial Management Service (FMS) division, is leading the development of special accounts, known as electronic transfer accounts (ETAs), to make payments electronically to these persons. The implementing law requires the federal government to ensure that individuals without checking accounts have access to an account at a financial institution at a reasonable price. Ironically, we are within 90 days of the implementation date, and rules for these accounts are still in development. Institutions can follow progress at the Treasury Department's FMS website at [www.fms.treas.gov](http://www.fms.treas.gov).

Another dimension to EFT '99 is financial electronic data interchange (FEDI). Companies doing business with the federal government will also receive payments via direct deposit. Remittance information will accompany these payments in ACH addenda records. This information, known as FEDI, is usually attached to ACH transactions; but many banks lack the capability to process or translate the information. In September, the Federal Reserve began offering a new product, FedEDI. FedEDI permits banks to process FEDI using PC-based software. The software can be run on the same computer used for FedLine. For more information on FedEDI, you may contact the Federal Reserve Bank of Richmond.

## COMMISSIONER'S CORNER

E. J. Face, Jr.



As you know, the Commonwealth of Virginia may be home to at least 16 new/start-up banking organizations when all is said and done. By all accounts, this Bureau will investigate a record number of such de novo bank applications for 1997-98 and perhaps into 1999.

With so many new banks and new bank directors, the Bureau and the Federal Reserve Bank of Richmond have discussed the possibility of holding a "New Bank Directors' College" to aid new bank directors in understanding the banking system, their roles and responsibilities, and the regulatory and examination process.

Over the next few months, we will be talking with the Federal Reserve, setting dates and formulating our program for this College. My goal is to hold the first day-and-a-half College session in February or March 1999. I welcome any suggestions and comments.

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### **THE VIRGINIA STATE BANKER**

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